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THE GATEWAY INNOVATION CENTER: EXPLORING KEY ELEMENTS OF DEVELOPING A BUSINESS INCUBATOR

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Abstract: *Purpose* –The objective of this paper is to identify the key components to developing a successful business incubator as an effective tool for economic development based on the case study of an unsuccessful effort.
Design – The Gateway Innovation Center case study presents an opportunity to examine some possible pitfalls of developing a business incubator. A scant four months after opening, the organizers of the incubator decided to give up on the project. Exploring the various missteps in the formation of the Gateway Innovation Center provides a better understanding of key issues in developing successful incubators.
Originality – Very few business incubator failures are examined. This is one of the first case studies to examine the short life of a highly anticipated business incubator in an area of Southern California that was seeking to foster new businesses and create jobs in a region of relatively high unemployment.

Keywords: Business incubators, Incubator case study, Key issues in developing Business Incubators

Paper type Case study

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INTRODUCTION

In the United States (US) as well as internationally, business incubation has proven to be a highly successful element in economic development and job creation, innovation, technology transfer and diversification of the local economy and it will be the driver of the 21st century. The National Business Incubation Association (NBIA) is a leading organization in business incubators and for more than fifty years it has been supporting the start-up of business incubation in the US and worldwide. Today there are more than 7,000 incubation programmes worldwide (EDA, 2011). The US has the largest number of business incubator programmes in the world. In many ways, the US has been a pioneer in this industry, where the growth has been rapid, from less than 100 in the 1980s to about 1,800 in 2010 (NBIA, 2010).

The US government has played a predominant role in supporting incubators with legislative allocations for economic development and job creation (Chandra and Fealey, 2009; Monkman, 2010).

In addition, Business Incubation Programmes (Info Dev., 2009a) are aimed at promoting the economic development of their community by supporting start-up companies and their business development. These programmes offer services to support the establishment and development of new/small and medium companies. The programmes also provide the incubette with: 1) start-up consulting and business planning; 2) consulting in all areas important for business development and growth; 3) consulting for and/or access to financing; and 4) training and networking.

Many studies in the literature (AL-Mubaraki and Busler, 2010; 2011a; 2011b; 2012a; 2012b; 2013) have shown that incubators are value-adding by providing numerous business support services and fostering technological innovation and industrial renewal (Allen and Rahman 1985; Smilor and Gill 1986; Allen and McCluskey 1990; Mian, 1996a). They can be viewed as a mechanism: (1) to support regional development through job creation (Allen and Levine, 1986; Mian, 1997; Thierstein and Wilhelm, 2001), (2) to create new high-tech ventures, technological entrepreneurship, commercialization, and transfer of technology (Mian, 1997; Phillips, 2002; McAdam and McAdam, 2008), and (3) to provide an initiative to deal with market failures relating to knowledge and other inputs of the innovative process

(Colombo and Delmastro, 2002). The incubators aim to accelerate the start-up process of high value-added, high-tech companies by providing both technological and management assistance.

The objective of this paper is to identify the key components to developing a successful business incubator as an effective tool for economic development based on the case study of an unsuccessful effort.

HISTORY AND BACKGROUND OF ESCONDIDO

In 2006, the Southern Californian economy was doing very well, housing prices were up, unemployment was low, and retail sales were high, which generated lots of sales tax revenue for cities and towns. During this period, the city of Escondido, in northern San Diego County, decided to build a new police station and jail and put a bond issue to fund the building of the new station on the November ballot. The residents of the city passed the bond issue and plans were made to build the new police station in the northern part of the city.

The city of Escondido had a population of around 135,000 in 2000, which grew by around 10,000 people in the following decade. Approximately half of the city residents report having Hispanic or Latino origin and over 40 percent speak a language other than English at home. Median household income in 2006 was $60,883. The city covers slightly less than 37 square miles (59.5 sq km). In 2007 there were approximately 12,000 businesses within the city, with retail sales of $2,698,259,000. Retail sales per capita averaged $20,026 (Escondido Quick Facts, 2010 and Garrick, 2011a).

The city depends on sales tax revenue to pay for public safety and other vital services. It is more dependent on retail sales than most cities as one of the area's largest regional shopping malls, Westfield North County, is within its city limits, and there are twenty auto dealers in the city. The recent recession hit the city very hard. In 2006, the city posted record sales tax revenue of $33.5 million, but that number fell to $20.6 million in 2010. It was during 2010 that the idea for an incubator for start-up technology companies was first announced. The then mayor and city council endorsed a plan to transform the now vacant 44,000 square foot (13,411 sq meters) police station into an incubator site (Garrick 2010). The building had become vacant earlier in 2010, when the police and fire departments moved to their new 115,000 square foot (35,052 sq meter), three-story police station (Garrick 2010, Sifuentes 2010).

SAN DIEGO NORTH ECONOMIC DEVELOPMENT COUNCIL (SDNEDC)

The area north of San Diego, referred to as San Diego North, shown on the map in Figure 1, encompasses five cities (Carlsbad, Escondido, Oceanside, San Marcos and Vista) and unincorporated areas.

Approximately fifteen years ago, at the urging of a county supervisor, a coalition of private and public sectors banded together to form the North County Economic Development Council; the purpose of which was to "sustain and carefully grow the economic base of North County San Diego" (SDNEDC website, 2012). The Council, later renamed the San Diego North Economic Development Council, is a non-profit organization funded by public/private investments, membership dues, in-kind services, grants and special projects purchased by member customers. The goal is to partner with local governments, chambers of commerce, business councils, and health and education organizations to foster economic growth. The Founding President of the then NCEDC was from the city of Vista and had been a business consultant, active in area economic development activities for many years. He held the position of President for three years. He was followed by three very short-term Presidents until 2004, when a new CEO took over. The new CEO had a background in healthcare and non-profit organizations. During

Figure 1: New economic development group's study area

his tenure as CEO, the organization grew; he instituted an annual holiday luncheon and awards ceremony, a Rapid Response programme to help laid-off employees and helped the organization to build regional partnerships for economic development.

The new SDNEDC CEO was knowledgeable about the economic development efforts of all the regional cities and in 2010 presented the city of Escondido with a proposal to use the old police station as an incubator site. At the time, August 2010, two of the council members, who made up the economic development sub-committee wanted to pursue the proposal, but only on a short-term basis. The mayor said the incubator would help lead the way for other technology firms to follow suit. The proposal was to give start-ups very low-cost leases as incentive to locate in the old police station. Another council member, who later became mayor, said he supported the idea but thought it was important that such proposals be part of a more comprehensive economic development plan. The city had received several proposals to redevelop the site since 2006, all of which had been rejected. City officers had more ambitious plans for the old site but felt more appropriate proposals would probably not come forward until the economy recovered.

In the meantime, the SDNEDC, which was then housed in an office building in the neighbouring city of San Marcos, was notified that it was losing its lease. This happened shortly after the SDNEDC CEO had submitted his proposal for an incubator to the Escondido City Council. He proposed that the SDNEDC move its offices to the old Escondido police station. The SDNEDC Board considered and approved the proposal to move its offices to two or three rooms in Escondido's old police station with the intention of developing the proposed business incubator in the building. On November 17, 2010, a three-year lease agreement was presented to the City Council. As part of the agreement, the SDNEDC would pay rent of one-dollar ($1.00) per year to the City of Escondido. The lessee was to pay all utilities, taxes, assessments and fees. The agreement further stated that the lessee had "inspected the Premises, that the LESSEE accepts said Premises "as is" and "where is," that the Premises are in good and sanitary order, condition and repair. Lessee hereby accepts the Premises as such" (City of Escondido Lease Agreement: 11-17-10). These last two provisions later became problematic. The agreement also stated that either party could terminate the agreement with a written 90-day notice to the other party. The actual lease agreement was revised to reflect the requirement that sub-lessees (start-ups) stay in Escondido for a minimum of three years after leaving the incubator and that the city would cover costs of utilities above $3,000 per month between January and July of 2011. The revised lease was signed on January 26, 2011.

The building was not in good condition. According to individuals associated with the premises, the former police station/jail was unsanitary, emitted unpleasantodours, paint was peeling, plumbing needed repairing and a variety of other upgrades were necessary. The building did not have internet access and was not a "smart" building in any way. The lack of technology interfaces would make it an undesirable location for any start-up technology oriented firm. The SDNEDC had anticipated that some federal incentives for creating technology clusters might be available to upgrade the old station, which even the city officials acknowledged had some roof leaks and an outdated ventilation system. Unfortunately, these anticipated funds did not materialize due to federal budget decisions related to the large federal government deficit.

Later in 2011, the SDNEDC moved into a couple of rooms on the second floor of the old police station. With no funds for major renovations, painting the rooms that housed the SDNEDC offices became a measure of success. Shortly after moving into the location it was burglarized twice.

THE GATEWAY INNOVATION CENTER

The first tenant of the Gateway Innovation Center was a company called Hydrogen Power Systems, which quietly moved into 1,000 square feet in the building during the summer of 2011. The company said it moved into the space because of the low rent and, in addition to office space, there was use of a garage where the company could make and test its equipment.

Not long after moving into the building the SDNEDC received a $27,000 tax bill for the assessed value of the property, which was said to be due immediately. The CEO of the SDNEDC was eventually able to negotiate with the county tax collector and got the collector to agree to possessory-use tax payments, which were to be $10,000—money that the SDEDC did not have.(Near the end of the year, the property was reassessed and the tax was quoted as $850 for the year.)

By October 2011, there were five tenants in the incubator, only one of which was a technology firm. The planned business assistance was not offered and the lack of business expertise by those running the center became a problem. At this point there was no business plan for the Gateway Innovation Center, the financial projections were dismal, and there was little hope that the required building repairs/renovations would take place. The first major publicity about the Gateway Innovation Center appeared in the local newspapers in late October 2011. The news releases included a piece written by the CEO of the SDNEDC about how business incubators are uniquely positioned to spark job creation. The press release said the SDNEDC would bring in fledgling high-tech companies that showed promise of growth (Fikes 2011a, 2011b). In recruiting for tenants, it was said that start-up companies would get office space, utilities and professional assistance for about $1 per square foot, per month, which was about 40 per cent below market rate. The head of the SDNEDC said several experts would be invited in to talk about various aspects of running a business. The publicity said that the Center could house around 13 start-ups, while the city council had anticipated that the Center would house 20-25 tenants.

A scant two months after the press releases announcing the opening of the center appeared, the organizers of North County's first technology incubator decided to give up on the project (Garrick 2011b). The SDNEDC gave the city the required 90-day notice to terminate the lease. At the time, only four start-up businesses were housed at the location. The city officials said the closing was due to financial problems, but a SDNEDC spokesperson said it was due to the state of disrepair of the building and the lack of funds to upgrade the location to a level that would make it attractive to start-up businesses. City of Escondido officials said they would try to help the four tenants find new locations. The CEO resigned his positions as President and CEO of SDNEDC in January 2012 (Persinger, 2012), citing health and personal reasons for his departure, neither of which were related to the failing incubator.

WHAT WENT WRONG?

The Chairwoman of SDNEDC attributes the lack of success to the following:

1) *Function following form*. Both the City of Escondido and SDNEDC had a large empty building (*form)* and decided to use it for a business incubator (*function)*. Good practice would suggest that one should decide on the type of incubator one wanted to create and then look for a location that would be appropriate.

2) *Lack of planning*. There was no business plan ever written for the business incubator. Financial projections were more "back of envelop" and had unrealistic expectations. Everyone talked about technology start-ups, but there was little planning for the types of resources and support technology start-ups would need.

3) *Lack of expertise*. No one associated with the Gateway Innovation Center had experience creating or working with business incubators. No one had been an entrepreneur or understood the needs of a start-up company. There were no admission criteria and no criteria for evaluating the potential of businesses.

4) *Lack of due diligence*. There was a lack of due diligence before signing the agreement with the City of Escondido. There was underestimation on costs of utilities, on costs associated with needed repairs, and the taxes that would need to be paid.

5) *Market area would not support a technology incubator*. The business mentality of North County is conservative. The area has many small businesses; however, technology start-ups and innovation are not well understood or embraced (Jan Jackson, Personal interview 23-4-12).

WHAT CAN BE LEARNED?

The idea of both the city and the SDNEDC was to have technology based start-ups, but there was no clear definition or criteria to qualify as a "technology" company. Whether the intention was to create an industry-specific incubator is not clear, as no mention of a specific type of technology firm was made. In some high-technology industry incubators, firms may be able to share expensive equipment, which reduces development costs, but there was no indication that this was part of any plan for the Gateway Innovation Center.

As is typical of most incubators in the US, incubators are funded as "not-for-profit" organizations and are frequently sponsored by local economic development organizations, which are reported to more likely focus on job creation, re-industrialization or revitalization of the local economy. It appears that both the City and the SDNEDC's goals were aligned with this focus. However, most economic development organization sponsored incubators are likely to offer business services, administrative assistance and some counselling in addition to shared office space. It appears that for the $1 per square foot monthly payment, the Gateway Innovation Center start-ups were given only space. Clerical and administrative support services were not provided and it does not appear that any counselling services were offered.

While the types and quality of services offered will vary among incubators, these will, in part, be based on the focus and purpose of the incubator. Markley and McNamara, in a 1994 working paper from Purdue University, state that the availability of management consulting services "may be the most critical contribution the incubator makes to a fledgling firm's success" (p.2). The Gateway Innovation Center had no one on staff to offer this type of service.

The reason stated by many for the success of firms graduating from incubators is that of admission standards. While admission standards may vary, the most important is the viability of the business idea. It appears that the success of an individual incubator is based, in part, on the ability and skill of the manager to attract the right tenants—those who would benefit from the services offered by that particular incubator. The manager or screening committee who makes the selection decisions also needs to have the business expertise and experience to understand and anticipate problems. Unfortunately, the Gateway Innovation Center did not have its own administrator with the requisite experience to make these decisions. The individual, whose titles were President and CEO of SDNEDC, was also attempting to recruit and administer the incubator. In addition, there were no articulated criteria for admission to the incubator, so it was difficult to make consistent or appropriate selection decisions.

CONCLUSION

The need for the creation of supportive environments for fostering new businesses has never been greater. All nations need to explore ways to foster job growth and economic development. One proven method to accomplish this task is through the creation of business incubators. A business incubator can be successful if there is appropriate understanding of the requirements for success. There needs to be a plan, appropriate resources must be available and the individuals associated with the incubator must have the requisite skills and knowledge to run a successful operation.

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